Rates to turn in record time: Bernstein

David Coe

An adviser to a number of US banks and hedge funds that survived the financial crisis believes global long-term interest rates will soon be heading back up after the longest, most persistent decline ever.

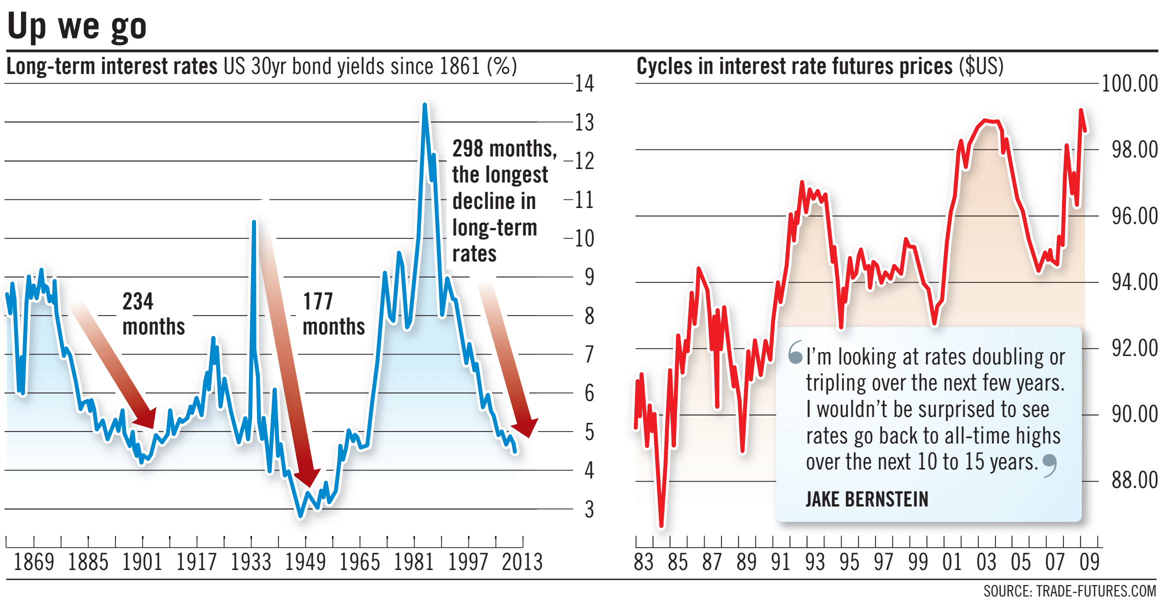
Despite the US Federal Reserve's trillion dollar efforts to buy bonds and push down yields, Jake Bernstein, a market veteran of 40 years and author of 21 books, said that on a long-term chart, he expected rates to turn quickly.

''After 298 months of decline in 30-year Treasury bond yields, the time is right for a major low — and I do mean major,'' he told *The Australian Financial Review.*

''Previously, we turned over a period of years but we live in a very different economy to that of the 1940s. Today's economy is much more dynamic, responsive and resilient,'' he said.

''I'm looking at rates doubling or tripling over the next few years. I wouldn't be surprised to see rates go back to all-time highs over the next 10 to 15 years.''

Mr Bernstein's call coincides with warnings from a clutch of respected international investors including



Berkshire Hathaway's Warren Buffett and Hong-Kong based investor Marc Faber, publisher of the *Gloom Boom & Doom Report*, that the massive amount of liquidity being pumped into the global financial system, coupled with unprecedented monetary and fiscal stimulus, will lead to an outbreak of inflation as the economy recovers.

This would swamp the Fed's efforts to keep yields low and force central banks around the world to raise rates to combat rising prices.

Some also warn the US dollar will collapse under the weight of the US's burgeoning debt, which would fuel a boom in commodities prices.

Mr Bernstein agreed, adding commercial players in the commodities markets have used the past year's falling prices to unwind their hedges and establish long positions.

''Long positions of the commercials precede bull markets and in some cases we are seeing the biggest long positions in history,'' Mr Bernstein said.

''Natural gas in particular has a huge amount of long positions.''

Mr Bernstein also cited copper and other non-precious metals as well as agricultural crops (in particular biofuels such as sugar and corn) as other commodities in which the long positions of investors would underpin a sustained rally.

Sydney-based market trader David Novac of Wealthwise Education agreed that policies to stimulate lending would have long-term consequences.

''The Federal Reserve's decision to pump another trillion dollars into the US economy to artificially inflate asset values, such as stocks, bonds and real estate, is just another nail in the coffin — but it really had no other choice,'' he said.

''What the Fed is effectively saying is: 'We want you the consumer to go and borrow as much money as you can so we can avoid a depression'.

''The future cost of taking this action is hyperinflation. The US dollar will become relatively worthless as gold and other commodities go to the moon,'' Mr Novac said.

Traders flirt again with risk positions

Derivatives
John Wasiliev

The upward trend in sharemarkets over the past three weeks is leading traders to take on more risk.

While day trading from the long side continues to be the favoured winning strategy in derivatives markets, several traders have been prepared to swap long equity positions into riskier long contracts for difference (CFD) positions, according to CommSec's head of CFDs, Peter Tardent.

Prompting their strategy is the relatively cheap cost of carrying such positions with interest rates now at less than 5 per cent.

''There has been a little bit more risk appetite returning to the market,'' Tardent says.

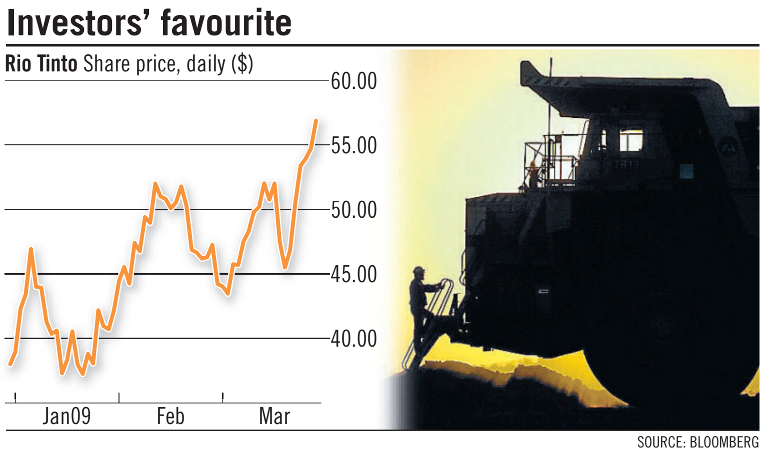
The market's performance over the past three weeks has definitely resulted in an improvement in sentiment among traders, says City Index market strategist Alex Douglas. Traders have been particularly keen on the big banks and on Telstra and Rio Tinto.

Another positive indicator, says James Staltari of Westpac Broking, has been a continued bias towards bought positions. Open CFD positions have shown a long-position bias of more than 4-to-1 over shorts, up from 3-to-1 the previous week. Overall open positions remain subdued, however, as a recent tilt towards shorter-term trading continues.

After being a popular long position for three weeks with a good amount of sub-$3 bottom fishing, Telstra last week brought home the bacon for CFD traders, says MF Global head of CFDs, Anthony Anderson.

Traders who took long positions on a 10 per cent initial margin doubled their money as the shares rallied over the $3.20 region. Telstra shares closed at $3.25 on Friday.

But Rio Tinto delivered the best result for traders, Anderson says, as some sizeable long positions were well rewarded.



Traders have been keen on Rio for some weeks and have recently ridden the price up from the mid-$40 region on a 20 per cent initial margin. With Rio, there is certainly no shortage of price-sensitive news such as comments from the company that it has a plan if the proposed $19.5 billion investment by China's Aluminum Corp is blocked by either the Foreign Investment Review Board or disgruntled shareholders.

Apart from Rio, Westpac Broking saw good derivative trading volumes in the banks, BHP, Woolworths and S&P/ASX 200 index options. In exchange-traded options activity, the expiry last Thursday of equity options resulted in higher trading volumes.

A bonus for options traders was that a number of positions moved into the money just before expiry because of overall stronger prices, especially long calls in the banks. This in turn caused the rolling of a large number of short option positions as traders bought them back.

Staltari says the bias towards short positions continues in the options market, but a clearer trend will develop this week as new positions are opened.

China in confidence offensive

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worst is over for markets. But commodity markets last week lost some upward momentum, which perhaps reflects a growing nervousness that this rally is only a short-lived correction in an ongoing bear market.

And this week markets are about to confront first-quarter US earnings reporting season, as well as the key S&P/Case Shiller index of US home prices, plus data on US manufacturing, consumer confidence and employment.

If these reports are worse than expected then the current glass-half-full view, with the focus on a few good economic numbers and the trillions being thrown at the flagging global economy by governments, could quickly revert into a glass-half-empty view with a focus on the worldwide recession.

The scraps of positive news, such as better than expected US durable goods orders and new home sales, are easily swamped by negative news, including out of China. The country's industrial companies' profits plummeted a record 37.3 per cent in the first two months of this year. Profits of state-owned companies fell 59.2 per cent, foreign-funded firms suffered a 39.3 per cent fall while private industrial enterprises saw a 3.3 per cent year-on-year growth in their earnings over January and February.

The top losers in the first two months of this year were steel mills, followed by manufacturing companies and those involved in the processing of non-ferrous metals.

Chinese exports are collapsing, global steel production is slumping, there are few signs of a pick-up in end user demand for any raw materials, Chinese industrial production growth has slowed sharply and excess industrial capacity in the country is ballooning.

These are not the preconditions for recovery.

Don't put the champagne on ice just yet

Wall Street
Jeff Sommer and Ken Prewitt

Despite a decline on Friday, the US stockmarket rose smartly again last week, extending its rally since March 9 to more than 20 per cent.

By one technical definition, an increase of that percentage above a market low could be viewed as a bull-market rally. But the swiftness of the recent upturn, after the devastating losses of the past 18 months, offered little assurance that the gains would be long-lasting.

Announcements of major policy initiatives by Treasury Secretary Timothy Geithner helped spur the advance. Last Monday, he offered a plan to cleanse bank balance sheets of toxic assets, and on Thursday, he proposed, in outline form, a far-reaching overhaul of financial regulation to forestall another crisis.

For the week, the Dow Jones Industrial Average climbed 6.8 per cent, to close at 7776.18.

The S&P 500 Index rose 6.2 per cent, to close at 815.94.

But analysts warn that more trouble could lie ahead for US banks.

''There may be more bad news on banks, even as the US economy improves in the second half of 2009,'' Goldman Sachs Group analyst Abby Joseph Cohen said.

''We're certainly not yet in the clear — whether in the US or around the world. While we have had a great deal of bad news on banks, we think there is still more to come.''

US stocks fell 2 per cent on Friday after the heads of JPMorgan Chase and Bank of America said results deteriorated in March. Both banks said earlier this month they were profitable in January and February.

The US economy was looking ''less bad'', Ms Cohen said, and might grow by the end of the year as the Obama administration's stimulatory efforts fed through.

> **We're certainly not yet in the clear – whether in the US or around the world.**
> Goldman Sachs Group's Abby Joseph Cohen

''The situation in Europe is of concern to us and economic activity in many countries is still lacklustre,'' the high-profile market analyst said.

Stock prices were ''too cheap'' about a month ago, prompting the market's recent rally, Ms Cohen said.

''Recessions are difficult and uncomfortable when you are going through them, but they do end,'' she said.

Her fears about US banks mirror those of Nobel Prize-winning economist Paul Krugman, who warned last week that the US government would have to take over major lenders.

Mr Krugman said the financial crisis would force the federal government to take control of big US banks.

He also predicted that the US economy, which shrank 6.2 per cent last quarter, would not stabilise until late this year.

The New York Times, Bloomberg